200243057

July 2, 2002

INTERNAL REVENUE SERVICE

UIL: 9999.98-00

TE/GE TECHNICAL ADVICE MEMORANDUM

T:EO:B4

Taxpayers Name:

Taxpayers Address:

Taxpayers ID No.:

Years Involved:

Conferences Held:

LEGEND:

B =
C =
D =
E =
F =
G =

H =
J =
K =
L =
M =
N =
P =
Q =

R =
S =
T =
U =
V =
City1 =
City2 =
City3 =
landlord =

ISSUES:

(1) Was B, C's former President, Executive Director and founder an IRC 4958 disqualified person in 1998 and years forward?

(2) Was B an IRC 4958 organization manager with respect to C in 1998 and years forward?

(3) Is any part of the $ salary paid to B in 1999 an IRC 4958 excess benefit to B?

(4) Is any part of the $ payment (back pay from 1998 and severance pay) to B in 2000 an IRC 4958 excess benefit to B?

(5) Were C's repayments of undocumented loans by B an IRC 4958 excess benefit to B?

(6) Were payments to E towing company in excess of the fair market value an IRC 4958 excess benefit to B, D, and E?

(7) Was the value of the auto furnished to B an IRC 4958 excess benefit to B?

(8) Was the value of autos furnished to B's wife, B's daughter and D, an IRC 4958 excess benefit to B?

(9) Does C's payment of $ for alleged loan payments to B constitute an IRC 4958 excess benefit to B?

(10) Does C's payment of $ to B's corporation, G, constitute an IRC 4958 excess benefit to B?

(11) Does C's payment for rent on property leased and used by B and D constitute an IRC 4958 excess benefit to B?

(12) Was C's payment to H for insurance an IRC 4958 excess benefit to B?

(13) Should IRC 6684 penalties be assessed against B?

(14) Is B subject to the organization manager tax under IRC 4958?

(15) Was B a promoter of a tax shelter under IRC 6700?

(16) Did B make or participate in making false, fraudulent, or gross valuation misstatements under IRC 6700?

(17) If so, is B liable for IRC 6700 penalties?

FACTS:

The following facts have been collected by the agent from statements made by members of C's Board of Directors and C's records currently under the control of those directors. Because this memorandum concerns the tax liability of B and the fact that many records were created and maintained by B, and under the control of B, the agent also made attempts to collect information from B on many occasions, by phone, correspondence and in person. These facts and the analysis that follows takes into consideration the fact that B has been given the opportunity to respond both orally and in writing to the many questions concerning the actual operations of C.

C is a tax exempt entity that is recognized as exempt under section 501(c)(3) of the Internal Revenue Code. B, who was a used car salesman, created C. The purpose of C is to allow individuals to donate their used vehicles for a tax deduction, and at the same time choose the nonprofit charity they wanted the proceeds to be sent to. If the donors do not designate a charity, the proceeds go into a general fund. The general funds, after expenses, are then distributed to various charities and social service organizations within the community.

C's exemption letter states that the "determination is based on evidence that [C's] funds are dedicated to the purpose listed in section 501(c)(3) of the Code. To assure [C's] continued exemption, [C] should keep records to show that funds are spent only for those purposes." C's Articles of Incorporation state "[n]o part of the net earnings of the corporation shall inure to the benefit of, or be distributable to, its members, trustees, officers, or other private persons, except that the corporation shall be authorized and empowered to pay reasonable compensation for services rendered and to make payments and distributions in furtherance of the purposes set forth in this Article."

C operated on the same premises as F. F is a used car lot owned by D, the son of B, and operated for a time prior to July 1998 and continuing from July 1998 through at least February 2000 at J. C used this lot to sell its donated vehicles to the public along side vehicles offered for sale by F. In November 1998, C began auctioning vehicles at a second location.

C's original Board of Directors consisted of: B, C's founder; B's wife; B's father-in-law, and a CPA. At all relevant times from incorporation until February 8, 2000, B was President, Executive Director and in control of C's activities. B stated there were four or five Board of Directors' meetings. They met in person in C's office. Directors also discussed things over the phone. According to B, they kept minutes which he left with

C. According to the new officers of C, they do not have copies of the minutes for 1998 and 1999.

The CPA, the only non-family member director, resigned on November 11, 1998. Agent secured a copy of the CPA's resignation letter, which stated that the thirteen checks he reviewed were enough to cause loss of C's 501(c)(3) status. Even after he explained to B that no part of any of C's revenues may inure to any private shareholder or individual as this will cause the loss of exemption, B continued with the same pattern of conduct. Additionally, the CPA indicated that no board meetings were held while he served as a board member.

Approximately two months before the agent did his on site examination, B relinquished his position as President and Executive Director of C, and "completely and commensurately" disbanded the old Board of Directors.

The examination findings respecting C's Car Donation Program disclosed that individual donors took charitable deductions greater than the fair market value of the donors' vehicles. In 1998, 1999 and part of 2000, C provided donors with only the retail Kelley blue book value, in writing, along with a signed Form 8283. C did not provide the loan or trade-in value, even though some of the vehicles were not able to be driven and were sold for scrap.

The following is a list of transactions between C and B and B's family:

1. B claims that he loaned C $ at % interest for start-up costs. However, there is no written documentation of any such loan. Neither C nor B provided the agent with a copy of a loan agreement between B and C. B admitted that there is no written loan agreement for this loan. Additionally, neither C nor B provided the agent with a copy of any loan agreement between C and any other party. There is no record of a resolution of the Board of Directors respecting any loan from B or any other party.

   C's 1998 Form 990, signed by B, reports a $ loan from an officer, director, trustee or key employee. (page 3, line 63). However, on Schedule A, Part III, question 2b, C answers no to the question of whether a loan was made with a trustee, director, officer, key employee or member of their family. Additionally, no interest expense was reported on page 2, line 41.

   C's 1999 Form 990, signed by L, reports a beginning balance of $ and an ending balance of $ of a loan from an officer, director, trustee or key employee. (page 3, line 63). However, on Schedule A, Part III, question 2b, C answers no to the question of whether a loan was made with a trustee, director,

officer, key employee or member of their family. Additionally, no interest expense was reported on page 2, line 41.

C supplied records that show three carbon copies of deposit slips totaling $, that purportedly correspond with these alleged loans: one dated 7/9/98 for $, with the notation - F LOAN; one dated 7/14/98 for $, with the notation G (LOAN); and one dated 7/28/98 for $ with the notation G. On the $ deposit slip the word "loan" is written in ink on the carbon copy. The three deposit slips do not have a bank stamp acknowledging that the deposits actually were made.

The agent's analysis of C's bank statements indicates deposits of $ were made in the month of July, 1998. Additionally, there were expenses for "Loan Payback" in the amount of $

C has also supplied a spreadsheet that is purportedly a payback schedule of these alleged loans containing dates, amounts, interest charges, and balances. This schedule indicates an interest rate of %. This schedule lists payments of $ and credits for autos transferred with a value of $ Additionally, the schedule shows amounts of $ or $ as interest. This schedule indicates an overpayment of $ as of 3/1/00. There is no evidence to show that this schedule was made contemporanously as checks were being issued.

Checks executed by B and drawn on C's bank account with various notations related to "Loan Payable":

	Date	Payee	Amount
1)	10/06/98	F	$
2)	10/06/98	G	$
3)	10/17/98	Q	$
4)	10/23/98	B	$
5)	11/09/98	G	$
6)	11/10/98	B	$
7)	11/10/98	B	$
8)	11/16/98	Cash	$
9)	12/09/98	F or B	$
10)	12/15/98	F or B	$

Two of these checks totaling $ were issued to G. G was a floor plan company owned by B. Q is a third party whose relationship to B or C is unknown. Another payment was a check written for Cash for $. On the same day, B

issued a check payable to U in the amount of $ The new trustees indicated that B bought land in K for his personal use with these funds.

In a letter to CPA dated November 18, 1998, B stated "[t]he fact remains that C owes me money, and from time to time as it can afford it, I will be paid back the money owed me. I am charging C no interest, and am doing this simply because I want C to be a success ... ."

Neither B nor C have provided any other documentation evidencing a loan: no promissory note or other evidence of indebtedness, no record of the rate and amount of interest, no evidence of any security or collateral, and no fixed maturity date. While there were some records of alleged repayments by C to B, the repayments and the records were sporadic, haphazard, and informal.

2. C paid E towing company $ in 1998 and $ in 1999. E is a for-profit towing company created in October 1998 by D, the son of B.

The new trustees state that they do not use E towing services anymore because it is too expensive. D never did towing until his father began operation of C. The new trustees' towing services are approximately -% less than E's towing fees. The new trustees use three different towing companies and companies put bids in for their services. B, as President and Executive Director of C, never requested any written bids for towing services, he just assigned the towing service to his son D. Agent noted that at the beginning of C's Car Donation Program in September and October of 1998, C used another towing company, which charged $ for a tow in the City1 area, compared to $) that D was charging for a tow in the City1 area.

In 1999, E towing services received various advances on towing, which outside towing services would not have received. In some instances, E charged C two towing charges – one to tow the vehicle to one C lot, then another to tow the same vehicle to C's other lot.

3. According to the new trustees, C provided a leased 1999 at a cost of $ per month to B. There was no accountability for the use of this vehicle and the personal use of this vehicle was not reported on either a Form W-2 or 1099.

According to the new trustees, a 1991 car was donated to C, which B's wife drove. B's daughter, a C part-time employee, drove a donated 1991 DX. C spent money to fix these vehicles that were used by family members of B.

L, the officer manager of C in 1998 and 1999 stated that no accounting for the autos, verbally or in writing, was ever given. L also did not know if C's 1998 or 1999

Board of Directors approved the personal use of the autos. L did not attend any meetings nor did L see any minutes indicating any board directive or approval for use of these vehicles. As far as the current officers know these were simply unaccounted for benefits, given by C to B and his family.

4. D drove a 1982 that was donated to C. There was no accountability for the use of this vehicle and the personal use of this vehicle was not reported on either a Form W-2 or 1099.

5. A rental agreement between landlord and F, B, and D, for the 5 year period beginning February 1, and ending on January 30, was executed for the property located at J. C is not a party to this lease. B stated there was no written sub-lease agreement between F, B, D and C.

   F operated out of this location prior to July the date of C's incorporation. E also was located at the same property duri and C's current board stated that "during the years of ___ and F at various times could have had up to three quarters of the property." "The amount of space utilized by F or C could vary from day to day." Additionally, E/F was provided "space to accommodate 2 (two) car carrier roll backs, both of which have an overall length of 28 feet and one four car carrier that has the overall length of about 40 feet."

   Examination findings disclosed that C paid landlord $ in and $ in for rent on this property. C's records indicate that there were no payments made to C from F, E, B, or D for reimbursement of the rents paid by C.

6. Examination of C for the year ended on December 31, 2000 disclosed the following:

   There were no minutes kept by B, the former President and Executive Director for 1998 and 1999. When the new Board of Directors took over in February of 2000, they had monthly meetings and minutes were kept.

   The new Board of Directors are:

Name	Title	Date Joined Board
M	President (also the Auctioneer)	2/7/00
N	Vice-President	2/7/00
L	Secretary –Treasurer	2/7/00
P	Trustee	10/13/00
R	Trustee	4/1/00

L was C's office manager and N was an employee of C, when B was the President and Executive Director of C.

In February of 2000, when B resigned, L, N, and M were appointed to the Board of Directors and officers of C. L and N also formed a Partnership while they served as Secretary -Treasurer and Vice-President of C. The purpose of the Partnership was to consult with charities in the car donation program. There was no documentation to support an agreement between the Partnership and C. In 1998 and 1999, L and N received Forms W-2 for their compensation from C. In 2000, Forms 1099 were issued to L for $. and N for $, instead of Forms W-2. Examination findings confirmed that L, as Secretary - Treasurer and N, as Vice-President were involved in the everyday activities of C. L signed the organization's checks in 2000.

C and B entered into an agreement dated February 8, 2000, for B to relinquish his position as Director of C. M executed it as president of C. The new Board of Directors approved this resignation/change-of-control agreement. This agreement stated that B would immediately relinquish his position of Director of C and "completely and commensurately" disband the current Board of Directors. In turn, C will pay B for salary allegedly not received for seven months in 1998, plus two months severance salary -- a total of $ in regular bi-weekly payments, beginning February 22, 2000. B received a W-2 for $ from C for the year ending on December 31, 2000. There is no evidence of any severance agreement between C and B, other than this ad hoc agreement.

L and N stated that whatever measures were needed to acquire C out of the hands of B would be the prudent thing to do. This would allegedly allow the new Board of Directors to do what C was originally supposed to do.

There were no independent Board Members on C's Board of Directors for the years ending on December 31, 1998, 1999, or 2000. All Board Members of C were either employees of C or had a financial relationship with C.

7. Contemporaneous with the above change-of-control agreement, C also entered into an agreement with E towing company, dated February 8, 2000. This agreement stated the following:

   (a) C will pay E to purchase the 1995 ; for $ C will pay E this amount in monthly payments, at % interest of $ beginning with a first payment on March 15, 2000. E will be shown as a lien holder until the balance is paid in full.

(b) C will pay E to purchase the 1991 . for $. To do so, C will pay S a total of $ (the total payoff, to be paid within 10 days). C will pay E the balance of $ in 18 monthly payments, at % interest, of $ beginning with the first payment on March 15, 2000. E will be shown as a lien holder until the balance is paid in full.

(c) C will pay E $ on each of the following Fridays to include February 11, February 25, March 3 and March 10, 2000. Thereafter, C will pay E $ per week for 32 consecutive weeks, and $ for a final week (calculated to include .% interest throughout these 33 weeks).

(d) D may leave an Automobile Dealer License "housed" at a C location at his discretion, for his own purposes.

This agreement was signed by D for E and by M, as President of C. C can provide no evidence that a determination of the fair market value of the equipment contained in sections (a) and (b) of this agreement was made. Additionally, C cannot provide any documentation or explanation of the consideration for the payments contained in section (c). From February 11 to October 27, 2000 C issued 37 checks totaling $ to E. C's new board indicated that the % interest rate was determined by B as a fair interest rate.

8. Under the current officers in 2000, C ceased quoting only the Kelley Blue Book Retail value. It provides the donor, in writing, with the retail and wholesale values to use as a guide in determining the fair market values of their vehicles. It also sent along IRS Form 8283, and pointed out to those donors that were donating vehicles in need of major mechanical repairs that the wholesale value would not be an accurate figure to go by with regard to their vehicles. This practice was not part of the policy of C's former Executive Director and President, B.

It is no longer the policy of C to sell retail vehicles or wholesale vehicles to any retail customer or dealer. All cars are sold at the auction. The current officers believe that this practice is fair and affords everybody the same opportunity to buy vehicles at whatever the last bid brings. Employees and officers of C are allowed to bid on any vehicle at their auctions. These auctions are open to the public.

In 2000, C expanded from the City1 area into the City2 area. It operated two auctions a week, one in City1 and one in City2. The expansion was possible through C's partnerships with other charities. R was brought on as Director of Development. His sole purpose was to develop partnerships with charities, enabling those charities to generate monies not normally available to them. Since 2000, C splits all partnership donations and charities designated by donor on a 50/50 split,

with C absorbing all the costs for towing, reconditioning, auction fees, advertising, detailing and all costs of pamphlets or any other written material that would help them in their car donation program. Since B's departure, C has partnered with several nationally known charities.

9. There were four checks drawn on C's bank account and issued to H life insurance company. These payments included: 4/4/00 in the amount of $ 5/1/00 in the amount of $ 9/6/00 in the amount of $ and 10/6/00 in the amount of $ There are corresponding invoices to these checks. The first invoice listed G, the second lists C, the third lists V, and the fourth lists C, all with the same group number. The first two invoices list D and T as employees. The last two invoices list D, T and N as employees. There is a notation on the last invoice removing D from the invoice and C remitted only an amount for T and N. C's current management (R and P) were not employed at that time so they could not explain why this insurance premium was paid out of C's accounts.

APPLICABLE LAW:

Section 4958 was added to the Internal Revenue Code by section 1311 of the Taxpayer Bill of Rights 2, P.L. 104-168, 110 Stat. 1452, enacted July 30, 1996. The section 4958 excise taxes generally apply to excess benefit transactions occurring on or after September 14, 1995. The Report from the Committee on Ways and Means on the Taxpayer Bill of Rights 2, H.R. 2337, was submitted March 28, 1996. H. Rep. No. 506, 104th Cong., 2d Sess. (1996) 53. Proposed regulations were published in the Federal Register August 4, 1998, 63 F.R. 41486. The proposed regulations were replaced by temporary regulations that were published in the Federal Register January 10, 2001, 66 F.R. 2173. The temporary regulations were replaced by final regulations that were published in the Federal Register January 23, 2002, 67 F.R. 3076. The final regulations, which apply as of January 23, 2002, represent a fair and reasonable interpretation of section 4958, based on the intent of Congress as expressed in the Report from the Ways and Means Committee submitted March 30, 1996. None of the section 4958 regulations cited below are more unfavorable to the taxpayer than the comparable provisions in the proposed regulations or the temporary regulations.

Section 4958(a)(1) of the Internal Revenue Code imposes on the participation of any organization manager, a tax equal to 25 percent of the excess benefit (the "first tier tax"). This tax must be paid by any disqualified person with respect to such transaction.

Section 4958(a)(2) of the Code imposes on each excess benefit transaction a tax equal to 10 percent of the excess benefit unless the participation is not willfuland is due to reasonable cause.

Section 4958(b) of the Code provides that where an initial tax is imposed, but the excess benefit involved in such transaction is not corrected within the taxable period, a tax equal to 200 percent of the excess benefit involved is imposed and must be paid by any disqualified person with respect to such transaction (the "second tier tax").

Section 4958(c) of the Code, in part, defines "excess benefit transaction" as any transaction in which an economic benefit is provided by an "applicable tax-exempt organization" directly or indirectly to or for the use of any disqualified person if the value of the economic benefit provided exceeds the value of the consideration (including the performance of services) received for providing such benefit.

Section 4958(e) of the Code defines "applicable tax-exempt organization" as an organization described in either section 501(c)(3) or section 501(c)(4) of the Code or an organization which was so described at any time during the five-year period ending on the date of the excess benefit transaction.

Section 4958(f)(1) of the Code defines "disqualified person" as (A) any person who was, at any time during the five-year period ending on the date of such transaction, in a position to exercise substantial influence over the affairs of the organization, (B) a member of the family of a disqualified person, and (C) a 35-percent controlled entity.

Section 4958(f)(2) of the Code defines "organization manager" as any officer, director, or trustee of an exempt organization or any individual having powers or resonsibilities similar to those of an officer, director, or trustee.

Section 4958(d)(1) of the provides that with respect to any excess benefit transaction, if more than one person is liable for any IRC 4958 tax, all such persons are jointly and severally liable for that tax.

Section 53.4958-1(e)(1) of the regulations provides that except as otherwise provided, an excess benefit transaction occurs on the date on which the disqualified person receives the economic benefit for federal income tax purposes.

Section 53.4958-3(c) of the regulations provides that voting members of the governing body, presidents, chief executive officers, or chief operating officers are persons who are in a position to exercise substantial influence over the affairs of the organization.

Section 53.4958-4(a)(1) of the regulations provides that to determine whether an excess benefit transaction has occurred, all consideration and benefits exchanged between a disqualified person and the applicable tax-exempt organization and all entities it controls are taken into account. In determining the reasonableness of

compensation that is paid in one year, services performed in prior years may be taken into account.

Section 53.4958-4(b)(1)(ii)(A) of the regulations provides that the value of services is the amount that would ordinarily be paid for like services by like enterprises under like circumstances (i.e., reasonable compensation). The standards under section 162 of the Code apply in determining the reasonableness of compensation, taking into account the aggregate benefits provided to a person. Section 53.4958-4(b)(1)(ii)(B) provides that the compensation for purposes of determining reasonableness under section 4958 includes all economic benefits provided by the organization in exchange for the performance of services, except for economic benefits that are disregarded for purposes of section 4958 of the Code under section 53.4958-4(a)(4).

Section 53.4958-4(b)(2) of the regulations provides that the facts and circumstances to be taken into consideration in determining the reasonableness of a fixed payment are those existing on the date the parties enter into the contract pursuant to which the payment is made.

Section 53.4958.4(b)(1)(ii)(B) of the regulations provides that, except for economic benefits that are disregarded for purposes of IRC 4958, compensation for purposes of determining reasonableness under section 4958 includes all economic benefits provided by an applicable tax exempt organization in exchange for the performance of services, including all forms of cash and noncash compensation, such as salary and severance payments; the payment of liability insurance premiums for a disqualified person; and all other compensatory benefits, whether or not included in gross income for income tax purposes, including taxable and nontaxable fringe benefits.

Section 53.4958-4(c)(1) of the regulations provides that an economic benefit is not treated as consideration for the performance of services unless the organization providing the benefit clearly indicates its intent to treat the benefit as compensation when the benefit is paid. An applicable tax exempt organization is treated as clearly indicating its intent to provide an economic benefit as compensation for services only if the organization provided written substantiation that is contemporaneous with the transfer of the economic benefit at issue. If an organization fails to provide this contemporaneous substantiation, any services provided by the disqualified person will not be treated as provided in consideration for the economic benefit for purposes of determining the reasonableness of the transaction.

Section 53.4958-4(c)(3)(i)(A) of the regulations provides that an organization's reporting constitutes contemporaneous substantiation to treat a benefit as compensation if the organization reports the benefit as compensation on an original Federal tax information return with respect to the payment (e.g., Form W-2 or Form 1099); or the recipient

disqualified person reports the benefit as income on the person's original Federal tax return (e.g., Form 1040); or there is an approved written employment contract executed on or before the date of the transfer indicating the benefit is compensation; or there is documentation by the organization's authorized body approving the transfer as compensation for services on or before the date of transfer; or there was other written evidence in existence before the due date of the applicable federal tax return indicating a reasonable belief by the organization that the benefit was a nontaxable benefit as described in Reg. 53.4958-4(c)(2).

Section 6001 of the Code provides that every person liable for any tax imposed by the Code, or for the collection thereof, shall keep adequate records as the Secretary of the treasury or his delegate may from time to time prescribe.

Section 6033(a)(1) of the Code provides, except as provided in section 6033(a)(2), every organization exempt from tax under section 501(a) shall file an annual return, stating specifically the items of gross income, receipts and disbursements, and such other information for the purposes of carrying out the internal revenue laws as the Secretary may by forms or regulations prescribe, and keep such records, render under oath such statements, make such other returns, and comply with such rules and regulations as the Secretary may from time to time prescribe.

Section 1.6001-1(a) of the Procedure and Administration Regulations in conjunction with section 1.6001-1(c) provides that every organization exempt from tax under section 501(a) of the Code and subject to the tax imposed by section 511 on its unrelated business income must keep such permanent books or accounts or records, including inventories, as are sufficient to establish the amount of gross income, deduction, credits, or other matters required to be shown by such person in any return of such tax. Such organization shall also keep such books and records as are required to substantiate the information required by section 6033.

Section 1.6001-1(e) of the regulations states that the books or records required by this section shall be kept at all times available for inspection by authorized internal revenue officers or employees, and shall be retained as long as the contents thereof may be material in the administration of any internal revenue law.

Section 6684 of the Code imposes a penalty on any person who becomes liable for tax under any section of chapter 42 (relating to private foundations and certain other tax-exempt organizations), equal to the amount of such tax, by reason of any act or failure to act which is not due to reasonable cause and either (1) such person has theretofore been liable for tax under such chapter, or (2) such act or failure to act is both willful and flagrant.

Section 6700(a) of the Code provides that any person who:

(1) (A) organizes (or assists in the organization of) a partnership or other entity, any investment plan or arrangement, or any other plan or arrangement, or

(B) participates (directly or indirectly) in the sale of any interest in an entity or plan or arrangement referred to in (A), and

(2) makes or furnishes or causes another person to make or furnish (in connection with such organization or sale) –

(A) a statement with respect to the allowability of any deduction or credit, the excludability of any income, or the securing of any other tax benefit by reason of holding an interest in the entity or participating in the plan or arrangement which the person knows or has reason to know is false or fraudulent as to any material matter, or

(B) a gross valuation overstatement as to any material matter,

shall pay, with respect to each activity described in paragraph (1), a penalty equal to the $1,000 or, if the person establishes that it is lesser, 100 percent of the gross income derived (or to be derived) by such person from such activity.

Section 6701(a) of the Code imposes a penalty on any person:

(1) who aids, assists in, procures, or advises with respect to, the preparation or presentation of any portion of a return, affidavit, claim, or other document,

(2) who knows (or has to reason to know) that such portion will be used in connection with any material matter arising under the internal revenue laws, and

(3) who knows that such portion (if so used) would result in an understatement of the liability for tax of another person.

Shall pay a penalty with respect to each such document in the amount determined under subsection (b).

Section 6701(b) of the Code provides that the amount of the penalty imposed by section 6701(a) shall be $1,000.00.

Greg R. Vinikoor v. Commissioner, T.C. Memo. 1998-152, held that whether a loan exists depends on all the facts and circumstances, including whether:

(1) There was a promissory note or other evidence of indebtedness;
(2) Interest was charged;
(3) There was security or collateral;
(4) There was a fixed maturity date;
(5) A demand for repayment was made;
(6) Any actual repayment was made;
(7) The transferee had the ability to repay;
(8) Any records maintained by the transferor and/or the transferee reflected the transaction as a loan; and
(9) The manner in which the transaction was reported for Federal tax purposes is consistent with a loan.

In Founding Church of Scientology v. United States, 412 F.2d 1197 (Ct. Cl. 1969), cert. den., 397 U.S. 1009 (1970), an organization argued that the Court should not find that the organization's earnings have inured to its founders since it had made some payments to him as repayments on a loan. The organization could not, however, produce any documents evidencing indebtedness. The Court concluded that the plaintiff had failed to meet its burden of proof that a part of the corporate net earnings was not a source of benefit to private individuals.

In John Marshall Law School v. United States, 228 Ct. Cl. 902 (1981), The law school and the college paid for the founding family's automobiles, education, travel expenses, insurance policies, basketball and hockey tickets, membership in a private eating establishment, membership in a health spa, interest-free loans, home repairs, personal household furnishings and appliances, and golfing equipment. The court determined that the expenditures for the founding family were not ordinary and necessary expenses in the course of the law school's and the college's operations. The court also found that the payment of college expenses for the founder's children by the law school provided direct and substantial benefits to the founder of the law school and his brother. The payment of the college expenses helped to defray the costs of their children's education, a cost which they otherwise would have had to satisfy from other resources. The court found these payments to constitute prohibited inurement of the law school's earnings to the founder and his brother, parents of the students.

In Bailey v. United States, 927 F. Supp 1274 (D. Ariz. 1996), aff'd, 117 F.3d 1424 (9th Cir. 1997), a tax preparer prepared the individual returns for a couple and for their closely-held corporation. Following an audit, the Internal Revenue Service imposed civil penalties upon the tax preparer. The court held the imposition of a penalty under

Moreover, the record indicates that it was the custom and practice of C and B to provide each donor, in writing, with only the retail Kelley Blue Book value of the donated vehicle, together with an IRS Form 8283. This was done for all vehicles, regardless of the condition of the vehicle. In many cases, the vehicles were inoperable and had to be resold by C as salvage or scrap. In issue 16 below, we have concluded the B, through C, aided and abetted understatement of the tax liabilities of donors to C.

Given these circumstances – the failure of B to carry his burden of proving what if any salary was reasonable, and his activities to aid and abet understatement of tax liabilities – we conclude that all of the $ must presumptively be treated as a section 4958 excess benefit to B.

If credible, probative evidence can be provided of any time in 1999 B spent administrering a charitable program of C, and of the value of such services, then it is possible that such value might be used to reduce the $ excess benefit.

Issue 4 – Is any part of the $ payment (back pay from 1998 and severance pay) to B in 2000 an IRC 4958 excess benefit to B?

As part of the reorganization of C under new directors in 2000, C agreed to pay a total of $ to B as alleged back pay for part of 1998 and as severance pay. Similar to the situation described in Issue 3 above, there is no evidence of the number of hours worked by B during 1998, the nature of his services, or comparable salary for similar services. There is also no evidence of any severance agreement between B and C, apart from the ad hoc agreement reached by the new Board of Directors in 2000. Moreover, the new Board of Directors had actual knowledge of the improper payments made by B to himself during his tenure as an officer of C, and yet they made no effort to obtain repayment of these amounts, Instead, they agreed to pay B an additional $. In these circumstances, this payment constituted a section 4958 excess benefit transaction to B.

Moreover, the record indicates that it was the custom and practice of C and B to provide each donor, in writing, with only the retail Kelley Blue Book value of the donated vehicle, together with an IRS Form 8283. This was done for all vehicles, regardless of the condition of the vehicle. In many cases, the vehicles were inoperable and had to be resold by C as salvage or scrap. In issue 16 below, we have concluded the B, through C, aided and abetted understatement of the tax liabilities of donors to C.

Given these circumstances – the failure of B to carry his burden of proving what if any salary was reasonable, his activities to aid and abet understatement of tax liabilities; and C's new board of Directors failure to consider his improper operation of C – we

section 6701 of the Code did not require that the return be used. The preparer could not claim mistake or mere negligence because his own testimony demonstrated knowledge. He aided or assisted in the preparation or presentation of tax related documents, knowing that if used, a tax liability understatement would result.

ANALYSIS:

Issue 1 – Was B, C's former President, Executive Director and founder an IRC 4958 disqualified person in 1998 and years forward?

Section 4958(f)(1) of the Code defines "disqualified person" as including any person who was, at any time during the five-year period ending on the date of a transaction, in a position to exercise substantial influence over the affairs of the organization.

Section 53.4958-3(c) of the regulations further provides that voting members of the governing body, presidents, chief executive officers, or chief operating officers are persons who are in a position to exercise substantial influence over the affairs of the organization.

B was the founder of C, having incorporated C on May 6, 1998. B served as a member of the board of Directors, President, and Executive Director of C. At all times until he relinquished control of C on February 8, 2000, he was in a position to exercise substantial influence over the affairs of C. Therefore B was a disqualified person within the meaning of section 4958(f)(1) of the Code.

Issue 2 – Was B an IRC 4958 organization manager with respect to C in 1998 and years forward?

Section 4958(f)(2) of the Code defines "organization manager" as any officer, director, or trustee of an exempt organization or any individual having powers or responsibilities similar to those of an officer, director, or trustee. B was the founder of C, having incorporated C on May 6, 1998. B served as a member of the board of Directors, President, and Executive Director of C. Therefore B was an organization manager within the meaning of section 4958(f)(2) of the Code.

Issue 3 – Is any part of the $ salary paid to B in 1999 an IRC 4958 excess benefit to B?

C paid B $ in "salary" in 1999. Neither C nor B has provided any evidence of the number of hours B worked. He has not documented or described the services that he provided. He has provided no evidence of comparable salaries for similar services. There were no Board minutes authorizing the payment of his salary.

conclude that all of the $ must presumptively be treated as a section 4958 excess benefit to B.

If credible, probative evidence can be provided of any time in 1998 or 2000 B spent administering a charitable program of C, and of the value of such services, then it is possible that such value might be used to reduce the $ excess benefit.

Issue 5 – Were C's repayments of undocumented loans by B an IRC 4958 excess benefit to B?

The clearest evidence of the existence of a loan is a written agreement between the parties. Neither C nor B provided a loan agreement evidencing any loan between C and B. Without an agreement we are left to determine its existence based upon the facts and circumstances. The burden of proof is on B to show enough facts and circumstances to determine the existence of a loan.

There is insufficient detail to determine the existence of a borrower/lender relationship between C and B. There is no record of a resolution of the Board of Directors respecting any loan from B. There is no evidence of any other action taken by C's Board of Directors. The failure to document any financial relationship between C and B is especially troublesome given the fact that B was the founder, director, president, and the person in control of C.

C's Form 990 information returns for the year 1998 and 1999 indicate that a loan(s) was received from from an officer, director, trustee or key employee. This information, however, is confused with evidence from the same returns that indicates that no loans were made by an officer, director, trustee or key employee. Additionally, no interest expense was recorded on C's financial statements.

There is insufficient evidence of a transfer of money from B to C as consideration of a loan. There is evidence of three deposits slips for C's bank account, two from G and one from F. First, it is not clear that these deposits were actually made and there is evidence that one slip may have been altered. Second, assuming these deposits were actually made, neither deposit came from B. B has not supplied any other documentation to show that he, in fact, lent money to C.

There is no evidence of a fixed maturity date or an actual repayment schedule. C supplied a spreadsheet which is purported to be a repayment schedule. The spreadsheet does not contain a date and it is impossible to determine if the schedule was made contemporanously with payments. The payments on the schedule do not correspond with amounts reported on C's Form 990, the three deposits purportedly made in July, 1998, or the checks written to B, F, G, Q, and/or cash.

The best that can be said based upon the evidence is that B disregarded (1) any sort of requirement to properly maintain C's accounts, and (2) proper form in the operation of C and B's other for-profit entities. When C needed money, he transferred money from one of his for-profit entities. When he needed money, as in the case of the downpayment for property in K, he wrote a check from C and labeled it "Loan Payable." C has written checks to cash, B, G, F, and Q and has labeled them "Loan Payable" for loans of which C has no documentation. There is no explanation why the alleged loan repayments were so sporadic or why no payment was made for almost a year.

Repayments of alleged loans to an organization's founder constitute a classic form of prohibited inurement. E.g., Founding Church of Scientology v. United States, supra. This same type of transaction also constitutes an excess benefit transaction. The burden of proving the existence of a loan rests on C and B. Vinikoor v. Commissioner, supra. The burden has not been met, and the alleged repayments to B thus constitute section 4958 excess benefits.

If credible, probative evidence can be provided by B to explain the many inconsistencies in the current information, then it is possible that such evidence might be used to determine, based upon the facts and circumstances, that a loan existed between C and B. The examination agent has the discretion to adjust all or part of the excess benefit transaction based upon such evidence.

Issue 6 – Were payments to E towing company in excess of the fair market value an IRC 4958 excess benefit to B, D, and E?

In October 1998, C made E its exclusive tow company for picking up and transferring donated vehicles. C made payments to E for these services rendered. On February 8, 2000, C entered into an agreement with E to purchase a ' at $ and a at $. along with agreeing to pay an additional $, all at an interest rate of ' %. It appears that E ceased providing towing services at that time.

The relationship between C and E towing company provided a section 4958 excess benefit to E and D for several reasons. D is the son of B and was the exclusive towing service provider of C. The fees charges by E were greater than fees normally charged by tow service providers in the area. The agreement entered into on February 8, 2000, compensates E unreasonably and without proper documentation.

D created E in October 1998, several months after his father created C. E immediately became the sole provider of towing services to C. However, C is not in possession of any service agreement between C and E. C has no board meeting minutes to indicate

that discussions concerning towing companies were being evaluated or that a bidding process was used. C has no notes or other writing to help determine why its previous tow company was replaced by E. It is unknown what the terms and conditions of this relationship was, who negotiated it, reviewed it, or signed off on it.

N (C's Director) indicated that E was created for the sole purpose of towing for C. Prior to E's creation, C used an unrelated towing company at a fee which was less than that charged by E. After B relinquished control of C, E ceased providing towing services to C. It appears that E sold its tow trucks to C and got out of the business.

The amounts paid to E varied but evidence indicates that they were in excess of the fair market value. After E ceased providing towing services, C used three different towing services, each charging substantially less than what E charged. For example, E charged $ for a tow in the City3 area, however, C currently pays $ (or less) for a tow in the City3 area. In the City1 area, E charged $ per tow and C currently pays $.

Additionally, under a February 8, 2000 agreement, C agreed to purchase two 1 from E. There is no indication that the s were purchased at fair market value. An appraisal was not obtained, nor was there any other attempt to determine the fair market value of the 1 .

C's payments to E resulted in a section 4958 excess benefit transaction to E and D. To the extent C's payments to E and D were in excess to the fair market value or reasonable compensation, they also constitute section 4958 excess benefits to B. E received these excessive payments from C solely by reason of the fact that it was the wholly owned company of the son of the president of C. If B had used his authority as president of C to take cash in the amount of the excess payments, place it in his personal bank account, and then transfer the funds to his son, the payments would obviously be excess benefits to B. The fact that the father, B, caused C to directly transfer the funds to the company of his son – the natural object of his bounty – cannot eliminate the father's excess benefit liability. See John Marshall Law School v. United States, 228 Ct. Cl. 902 (1981). Father and son have joint and several liability for the section 4958 excise taxes on these excess benefits. The examiner should determine the exact amount of the excess benefit, based on the extent to which the payments exceed the fair market value of the services rendered or property transferred.

Issue 7 – Was the value of the auto furnished to B an IRC 4958 excess benefit to B?

The value of the lease payments made by C on an auto leased by B is a section 4958 excess benefit transaction.

C does not have written documentation to show that the Board of Directors approved payments for B's leased vehicle either for C purposes or for his personal use. C has not adopted any policy concerning the payment or use of vehicles for C purposes or procedures for tracking their use. There is no accountibility for the use of this vehicle through the use of a logbook or other form of documentaton. Additionally, payment for personal use of the vehicle was not reported as income on either Form W-2 or 1099 to B. C had no accountable plan under Treas. Reg. 1.62-2(c).

C's lease payments were thus not substantiated as compensation pursuant to Reg. 53.4958-4(c)(1). Accordingly, the total amount of the lease payments constitutes an automatic excess benefit subject to section 4958 excise taxes.

Issue 8 – Was the value of autos furnished to B's wife, B's daughter and D, an IRC 4958 excess benefit to B?

The value of the autos furnished to B's wife, B's daughter and B's son constitutes section 4958 excess benefit transactions. These individuals received an economic benefit from personal use of these vehicles that were donated to C.

C does not have written documentation to show that the Board of Directors actually approved B's wife's, B's daughter's, or B's son's use of C vehicles either for C purposes or for their personal use. C has not adopted any policy concerning the use of C vehicles or procedures for tracking their use. There is no accountibility for the use of this vehicles through the use of logbooks or other forms of documentaton. Additionally, personal use of the vehicles was not reported as income on either Form W-2 or 1099 to the individuals.

Use of C's cars must be documented to show that their use is in furtherance of C's exempt purpose. Without documentation, it is impossible to show that a vehicles's use furthers an organization's exempt purpose. The value of these benefits was not substantiated as compensation, and thus constituted an excess benefit in their entirety.

The wife, daughter, and son of B are disqualified persons under section 4958(f)(1)(B). As explained under Issue 6 above, B, was responsible for improperly transferring assets from C and giving them to the natural objects of his bounty. Accordingly, B is jointly and severally liable for section 4958 sanctions on these excess benefits. See John Marshall Law School v. United States, supra.

The examiner should determine the fair market value of the use of these vehicles by the wife, daughter, and son. That value constitutes a section 4958 excess benefit.

Issue 9 – Does C's payment of $ for alleged loan payments to B constitute an IRC 4958 excess benefit to B?

C's payment of $ to B constitutes a section 4958 excess benefit transaction. B and/or F received economic benefit on payments recorded as Loan Payable for which no written documentation has been provided for the alleged loans. B prepared and executed all checks.

As discussed in Issue 5, B has shown little evidence that would indicate that any loan exists between C and B or F. B has not articulated any other reasons for the payments to F, B or Cash. Without documentation, B has not shown that the payments received from C were legimate loan payments.

Because the payments were not in furtherance of C's exempt purpose, the checks issued to or endorsed by B constitutes a section 4958 excess benefit transaction to B.

Additionally, the checks issued to or endorsed by F constitutes a section 4958 excess benefit to B. F was the wholly owned corporation of D, the son of B. For the reasons stated above, B is jointly and severally liable with his son for section 4958 excise taxes on these checks.

If credible, probative evidence can be provided by B to explain the many inconsistencies in the current information, then it is possible that such evidence might be used to determine, based upon the facts and circumstances, that a loan existed between C and B and/or F. The examination agent has the discretion to adjust all or part of the excess benefit transaction based upon such evidence.

Issue 10 – Does C's payment of $ to B's corporation, G, constitute an IRC 4958 excess benefit to B?

C's payment of $ to G constitutes a section 4958 excess benefit transaction. B received economic benefit on payments recorded as "Loan Payable," for which no written documentation has been provided for the alleged loans.

As discussed in Issue 5 above, B has shown no evidence that would indicate that any loan exists between C and G. B has not articulated any other reasons for the payment to G. Without documentation, B has not shown that payment to G was payment for products or services rendered by G. Because the payments were for the personal benefit of B and not for products or services rendered by G, the $ constitutes a section 4958 excess benefit transaction to B.

If credible, probative evidence can be provided by B to explain the many inconsistencies in the current information, then it is possible that such evidence might be used to determine, based upon the facts and circumstances, that a loan existed between C and B and/or G. The examination agent has the discretion to adjust all or part of the excess benefit transaction based upon such evidence.

Issue 11 – Did C's payments for rent on property leased and used by B and D constitute an IRC 4958 excess benefit to B?

C's payment of rent for property also used by B and/or D and/or F and/or E constituted a section 4958 excess benefit. B and D received an economic benefit by C making the rental payments that F, B and D were obligated to make, and by allowing E free use of the property.

Without Board approval or obligation to do so, C began making payments to the lessor of the property located at J in 1998. There is no evidence of a sub-lease executed by C. F continued to utilize the property after C began making lease payments. In addition, C allowed E to utilize space on the property without charge.

The lease payments were ultimately for the personal benefit of B to the extent they paid for space not occupied by C. See John Marshall Law School v. United States, supra. The lease payments were not substantiated as compensation, and thus constitutes automatic excess benefits subject to section 4958 excise taxes.

The examiner should determine the rental value of the space not occupied by C, and that value will constitute the amount of the excess benefit.

Issue 12 – Was C's payment to G for insurance an IRC 4958 excess benefit to B?

This issue addresses payments made by C to the H. It appears from the record that D, T, and N were employees of G. At no time was D an employee of C. It is unclear from the record whether T and N were employees of C. Neither C nor B have provided any documentation or other evidence to indicate that these payments were made for insurance coverage of C employees. C's new board members could not explain why these insurance premiums were paid out of C's accounts. Given these circumstances, the full amount of the payments constitutes an excess benefit to G, and therefore B.

Moreover, D was not an employee of C. C's payment of insurance premiums for the benefit of D is an excess benefit payment. Ultimately, even C realized they were paying D's premiums in error, however, no attempt was made to remedy this erroneous payment. Therefore, any payment by C for life insurance on behalf of D is a private benefit to D. Additionally, the amounts in payment of insurance coverage for D

constitute a section 4958 excess benefit to B. As discussed in Issue 6, B is jointly and severally liable with his son – the natural object of his bounty – for section 4958 excise taxes on these amounts.

Additionally, C made payment of invoices that clearly do not list C as the vendee. Payment for invoices that are the obligation of other entities is a benefit to the party whose obligation it was to make payment.

If credible, probative evidence can be provided that T and N were employed by C to administer a charitable program of C, that C provided an insurance benefit to its employees, and this insurance was intended to cover C employees, then it is possible that the value of the payments for insurance for those individuals might be used to reduce the excess benefit.

Issue 13 – Should section 6684 penalties be assessed against B?

Section 6684 of the Code states that if any person becomes liable for tax under any section of chapter 42 by reason of any act or failure to act which is not due to reasonable cause and such act or failure to act is both willful and fragrant, then such person shall be liable for a penalty equal to the amount of such tax. By this memorandum, B has been found to be liable for taxes under several sections of Chapter 42. B's accountant and former director of C explained to B that no part of any of C's revenues may inure to the benefit of any private shareholder or individuals, as this will cause loss of exemption. After being counseled by his CPA/co-director, B continued to engage in the activities that caused excess benefit transactions. Penalties under section 6684 of the Code should be assessed against B because these excess benefit transactions with C were not due to reasonable cause and the failure was a willful and flagrant act.

Issue 14 – Is B subject to the organization manager tax under IRC 4958?

Section 4958(a)(2) imposes a tax on the participation of an organization manager in an excess benefit transaction. As discussed in Issue 2, B was an organization manager within the meaning of section 4958(f)(2) of the Code. B's participation in these excess benefit transactions was willful and was not due to reasonable cause, within the meaning of section 4958(a)(2). B continued to participate in excess benefit transactions even after CPA, a former director of C, warned him of the ramifications of excess benefit transactions. After the CPA's warning and resignation from C's Board of Directors, B continued to knowingly participate in excess benefit transactions.

Issue 15 – Was B a promoter of a tax shelter under section 6700?

Section 6700 of the Code imposes a penalty on persons promoting an abusive tax shelter. Section 6701 imposes a penalty on persons who aid and abet the understatement of a tax liability. The penalty under section 6700 is in addition to any other penalty provided by law, except the penalty under section 6701. If the Service assesses a penalty under 6700, it cannot assess a penalty under section 6701 (or vice versa).

Because section 6700 and section 6701 are mutually exclusive and B's actions more easily satisfy the elements needed to impose the section 6701 penalty, we recommend pursuing section 6701 rather than section 6700 penalties. Therefore, no technical advice is being issued with respect to Issue 15. Issues 16 and 17 will be analyzed under section 6701 of the Code.

Issue 16 – Did B make or participate in making false, fraudulent, or gross valuation misstatements under section 6700?

As stated in Issue 15, it is more appropriate to analyze the facts of this memorandum under section 6701 of the Code.

Section 6701 of the Code provides for penalties for aiding and abetting understatement of tax liability. It applies to "any person . . . who . . . advises with respect to . . . the preparation or presentation of any portion of a return. .., who . . . has reason to believe . . . that such portion will be used in connection with any material [IRC] matter. . ., and who knows that such portion (if so used) would result in an understatement of the liability for tax of another person."

In the instant case, B was President, Executive Director and day-to-day manager of an organization whose principal purpose was to solicit donations of automobiles to C. The major thrust of the promotional literature prepared by C under B's supervision was that donors would obtain a substantial section 170 charitable deduction for the value of the donated vehicle. B was an experienced used car dealer, and well knew the approximate value of used automobiles. Ignoring this knowledge, B instead sent to each donor the Kelly Blue Book retail value of the donor's automobile, together with a copy of the IRS Form 8283 used by donors to claim charitable contributions for the value of donated automobiles. He made no attempt to provide donors with the more relevant, and much lower, Kelly wholesale or salvage value of the donated automobile. He provided this information even though he knew that many of the donated vehicles could only be sold for salvage or scrap.

As a direct result of this misleading information, several donors claimed greatly overstated valuations in taking section 170 deductions for their vehicle donation. Under these circumstances, B has "advise[d] with respect to . . . the preparation or

presentation of a .. portion of a return," and had "reason to believe . . . that such portion will be used in connection with" a "material" section 170 deduction.. . ." Section 6701(a). Moreover he knew that such deduction " would result in an understatement of the liability for tax" of [the donor]." Ibid. Therefore B participated in making false, fraudulent, and gross valuation misstatements under section 6701.

Issue 17 – If so, is B liable for section 6700 penalties?

As stated in Issue 15, it is more appropriate to analyze the facts of this memorandum under section 6701 of the Code.

As discussed in Issue 16, B participated in making false, fraudulent, and gross valuation misstatements. Accordingly, B is liable for section 6701 penalties. A penalty of $1,000 with respect to each person to whom B provided a false valuation should be imposed upon B. The penalty applies to each false valuation regardless whether it was or was not used to claim an overvalued deduction. Bailey v. United States, 927 F. Supp 1274 (D. Ariz. 1996), aff'd, 117 F.3d 1424 (9th Cir. 1997).

CONCLUSIONS:

(1) B was a disqualified person within the meaning of section 4958(f)(1) of the Code in 1998 and years forward.

(2) B was an organization manager within the meaning of section 4958(f)(2) of the Code in 1998 and years forward.

(3) The $ salary paid to B in 1999 is an IRC 4958 excess benefit transaction to B.

(4) The $ payment (back pay from 1998 and severance pay) to B in 2000 is an IRC 4958 excess benefit transaction to B.

(5) C's repayment of undocumented loans by B is an IRC 4958 excess benefit transaction to B.

(6) C's payments to E towing company in excess of the fair market value an IRC 4958 excess benefits to B, D, and E Towing.

(7) The value of the payments for a vehicle leased by B is an IRC 4958 excess benefit transaction to B.

(8) The value of autos furnished to B's wife, B's daughter and D is an IRC 4958 excess benefit transaction to B.

(9) C's payment of $ for alleged loans payments to B constitutes an IRC 4958 excess benefit transaction to B.

(10) C's payment of $ to B's corporation, G, constitutes an IRC 4958 excess benefit transaction to B.

(11) C's payments for rent on property leased and used by B and D constitutes an IRC 4958 excess benefit transaction to B.

(12) C's payment to H for insurance is an IRC 4958 excess benefit transaction to B.

(13) Section 6684 penalties should be assessed against B.

(14) B is subject to the organization manager tax under IRC 4958.

(15) It is more appropriate to analyze the facts of this memorandum under section 6701 rather than section 6700. Therefore, no technical advice is being issued with respect to Issue 15.

(16) B made and participated in making false, fraudulent, or gross valuation misstatements under section 6701.

(17) B is liable for section 6701 penalties.

A copy of this memorandum is to be given to the taxpayer. Under section 6110(k)(3) of the Code, it may not be used or cited as precedent.

- END -